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Explaining Threshold Effects of Globalization on Poverty

An Institutional Perspective

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Abstract

The paper focuses on the non-linearity of the transmission of the impact of globalization on poverty and the existence of threshold effects. Institutions constitute a critical factor for the creation of threshold effects in the impact of globalization on poverty. Institutions—their credibility, ability to be transformed by globalization, and the ways they give the poor access to the beneficial effects of globalization—determine whether the benefits of globalization are spread to the poor or are locked in by particular groups. They also determine whether or not the negative shocks associated with globalization are transmitted in an unfettered manner. The paper presents a theory of institutions that distinguishes several components, which evolve differently and explain the threshold effects that institutions generate upon the impact of globalization on the poor. The paper then shows that social institutions and norms have a critical role in the generation of these threshold effects. It finally examines the interactions between social institutions and state policies institutions, which may contribute to the formation of poverty traps.

Keywords: institutions, poverty, globalization, social norms

JEL classification: B52, P48, Z13

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Introduction

Globalization and poverty represent broad, multidimensional concepts which refer to phenomena that transform themselves in space and time. The literature on the impacts of globalization on poverty points to highly variable outcomes, both positive and negative, as well as multiple causalities, channels and mechanisms that link globalization and poverty. Studies observe different results depending on the channels, historical period, and the region or country considered. As is known, the inconclusive or variable character of these findings is a matter of intense debate, as are the concepts of globalization and poverty themselves.

This paper argues that this variability of outcomes stems from a key feature of the impact of globalization on poverty, which is the non-linearity of transmission of globalization's impact and the existence of threshold effects. It also argues that institutions constitute a critical factor in creating these threshold effects in the transmission of the impact of globalization on poverty. Analyses that focus on globalization and global poverty increasingly stress the importance of institutions. No existing work, however, has examined institutions in relation to the threshold effects that characterize the links between globalization and poverty.

The paper also shows that institutions create discontinuities and generate threshold effects upon the impact of globalization on the poor. Institutional environments and the presence or absence of critical institutions indeed determine whether the benefits of globalization are harnessed and spread to the poor, whether these benefits are locked in by particular groups with the poor being excluded from them, or the negative shocks associated with globalization are transmitted to the poor in an unfettered manner. Institutions introduce these threshold effects because of their composite nature: institutions are indeed made of distinct components—forms and contents (functions, mental models, for example)—which evolve differently. In particular, institutions may generate processes of cumulative causation and self-sustained poverty traps. The impact of globalization on poverty in a given setting is positive or negative depending on the multiple characteristics of the various components of institutions: among others, their historical depth, credibility, the way they combine, their ability to be transformed by globalization, and the ways they give the poor access to the effects of globalization that are beneficial to them.

The paper is structured as follows. Section 1 discusses the definitional issues associated with the concepts of globalization, poverty and institutions, as well as the different causalities and the heterogeneity of the processes that link globalization, poverty and institutions. Section 2 presents a theory of institutions as composite arrangements: this composite character explains the existence of the threshold effects that institutions generate upon the impact of globalization on the poor. Section 3 highlights the influence of the domestic political economy on institutions and its contribution to the threshold effects that modify the impact of globalization. Section 4 shows the critical role of social institutions and norms in the generation of these discontinuities and threshold effects. Section 5 examines the interaction between social institutions, public institutions and policies and macroeconomic conditions, which may contribute to the formation of poverty traps. The final section offers brief concluding remarks.

1 Globalization, poverty, and institutions: definitions and causalities

1.1 Globalization and poverty

The concepts of globalization and poverty remain the objects of intense debate, in particular with regard to the definitions and indicators of globalization: integration in the commodity, labour, and capital markets,[1] 'freedom and ability of individuals and firms to initiate voluntary economic transactions with residents of other countries', and 'greater mobility of capital and labour'.[2] Globalization encompasses heterogeneous elements: facts (flows, such as trade, capital, labour, migration, information, and market integration) and policies (reduction of barriers on trade, financial flows and migration, liberalization). Depending on the aspect of globalization considered, the function of institutions differs. They may provide credibility to government's commitments and policies, enforce property rights for foreign investment, and reduce information costs and allow the pooling of risks for small-scale farmers.

The concept of poverty has re-emerged in academic research as well as the agenda of international financial institutions in the 1990s (Kanbur and Lustig 2000), and, as noted by Deaton (2004), economic development has been increasingly conceived as poverty reduction rather than economic growth. Poverty, as is well-known, has many dimensions (subjective and objective, relative and absolute, and monetary and non-monetary). Measurement remains a key issue and, as highlighted by Ravallion (2003, Chen and Ravallion 2004), divergence in the assessment of the impact of globalization on poverty mostly stems from differences in the definitions, data, and measurement assumptions. Institutions intervene in all these aspects—their definitions, and the methods of assessing their effects—to contribute to divergence in the analyses of this impact.

The channels of transmission from globalization to poverty reduction are numerous and include economic as well as political economy channels (government policy, domestic allocation, technology transmission) that affect wages, employment, household production, and consumption (Goldberg and Pavcnik 2004). As shown by a number of studies, one has to differentiate the impact of globalization on growth and the impact of growth on poverty—globalization impacting on poverty directly through changes in relative prices and indirectly through growth effects.[3] There is a consensus, despite a few dissenting studies,[4] that globalization is positive for growth and hence for reducing poverty.

Globalization has improved the situation of the poor in certain countries and regions but not in others. Sub-Saharan Africa is the region most affected by poverty where the impact of trade openness since the reforms of the 1980s has been mixed. Many

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1 Definition provided in Bordo, Taylor and Williamson (2003).

2 As defined by the World Bank, quoted in Milanovic (2003a).

3 Nissanke and Thorbecke (2004); another well-known issue is the elasticity of poverty reduction to growth and initial inequality, see Bourguignon (2004a).

4 Rodriguez and Rodrik (1999); see in a historical context Clemens and Williamson (2001).

explanations for this have been provided, such as economic and geographical constraints (climate), policy (resistance to reform) and institutional factors.

Sub-Saharan Africa (SSA) is a clear example where, in addition to economic determinants, the presence or absence of certain institutions constitutes additional factors that promote or hinder the transmission of global forces to the poor, as well as induce discontinuities and unexpected consequences.

1.2 The difficulty in defining institutions

Institutions mediate the various channels and mechanisms of the effects of globalization and explain the latter's diversity, heterogeneity, and non-linearity. Definitions of institutions remain, however, a debated issue. Institutions are coextensive to societies and economies, as there cannot be a society without institutions;[5] institutions are simultaneously a particular dimension in the regulation of human activity. Institutions in essence depend on contexts, whether in the definitions based on transaction costs set up by the new institutional economics, in the game equilibrium perspectives (evolutionary or repeated games),[6] or in the evolutionary theory that focuses on learning processes and competition (Nelson and Winter 2002). Douglass North's (1990, 1991) definitions are the best known: institutions are constraints that structure political, economic, and social interactions and consist of informal—i.e., self-enforcing—constraints (sanctions, taboos, customs, traditions, codes of conduct, conventions, norms of behaviour) and formal regulations (constitutions, laws, property rights).

Definitions and functions of institutions are sometimes confused in the literature. The boundaries of institutions are also often fuzzy. Institutions may be defined as sets of property rights as well as devices aimed at the protection of these property rights. They are also defined as devices reducing transaction costs, instruments allowing stable anticipations, strengthening incentives, channelling resources, flexible responses to uncertainty, and so on. Characteristics of institutions, such as trust or credibility, are also often confused with the institutions themselves. Institutions may also be equated to a type of infrastructure (other than physical infrastructure). Similarly, the distinction between institutions and policies is sometimes unclear. Policies are the outcomes of state institutions, such as trade or taxation policies (institutions and policies or policy outcomes may even be synonymous in some studies), but policies also determine institutions—they create or reform institutions.[7]

Institutions are also alternatively viewed as both causes and effects. As argued by North and Thomas (1973, quoted by Hoff 1995), 'innovation, economies of scale, education, capital accumulation … are not causes of growth; they are growth'. Likewise, property rights may be viewed simultaneously as institutions and the outcomes of institutions, as state institutions protect property rights. The literature, however, recognizes that many

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5 As highlighted by Kaushik Basu in his comments of this paper (2004).

6 A conceptual framework is in Aoki (2001).

7 Levels of taxation or infrastructure are assimilated to institutions in the World Bank's *World Development Report 2005* on the investment climate.

institutions have no link with property rights (for example, the easing of exchanges and transactions).

1.3 The various categories, domains, and levels of institutions

Institutions may be categorized according to a series of dichotomies: state and non-state; market and non market; formal and informal, though these dichotomies are weakened by many problems of definition, logical consistency and conceptual overlap (Sindzingre 2004). Institutions are also domestic or external to countries (supra-state), which is a dimension of globalization (the so-called 'global governance'). In poor and weak states this is compounded by their dependence on aid and policy conditionality.

Institutions also regulate different domains of human activity: economic (when generating market-oriented incentives or protecting property rights), political (when managing conflict or enhancing political stability),[8] and social. Institutions regulating social relationships consist of sets of social norms that operate at the household, territorial, and group levels. These have been analyzed by transaction costs theories and theories based on asymmetries of information. The latter have explained several agrarian institutions in poor countries, such as interlinked markets (credit, insurance, land, for example) (Bardhan 1989).

At a microeconomic level, institutions and norms introduce thresholds in the causal link between globalization and poverty, for example, the institutions that favour or prevent collective action, regulate personal exchanges, social relationships and inequalities for individuals, households and groups—in particular redistributive institutions and insurance mechanisms, which may either redistribute or concentrate the gains of liberalization.

At a macro level the state partitions globalization flows (trade, capital, labour) between external and internal flows that fall under state prerogatives and rules. Thresholds in the impact of globalization stem in the first place from artefacts such as borders, which show resilience in a context of globalization.[9] As is well-known, dynamics of global inequality differ according to whether or not inequality occurs within or between countries. The state provides credibility—because it represents the highest level of capacity to commit—to other levels of public institutions (legal, parliamentary, economic) and to government policies. The state has a key role in channelling the impact of global integration. Early development economists viewed the role of the state, of domestic policies and of institutions as analytically pre-eminent in developing countries, as the state is able to reallocate better than the markets the factors of production towards growth. This has been the framework of the 'big push' policies or of the 'developmental' states' industrial policies in East Asia. The state, however, has also intensified the negative impact of globalization on poverty, as shown by cases of 'weak' and predatory states, such as in SSA.

8 On the links between institutions and growth, Rodrik, Subramanian and Trebbi (2002).

9 States have rather tended to multiply in the twentieth century, see Alesina and Spolaore (1997).

State institutions may or may not be able to provide rapid and flexible policy responses to external shocks, help the poor to cope with these shocks (such as volatility in the price of inputs), address market failures that primarily affect the poor (such as information asymmetries), or support particular market structures that are more effective in terms of risk management such as economic diversification. Likewise state institutions may or may not help to develop savings and investment as well as the entrepreneurial capacities of the poor, promote the marketization of goods that are produced by the poor, or reduce vulnerabilities that stem from the dualism and imbalances of employment structures, such as the pre-eminence of the primary sector (agriculture or natural resource extraction) compared to off-farm employment.

1.4 Institutions, poverty and globalization: multiple-way causalities and heterogeneous processes

The relationship between institutions and economic growth and development is the object of a vast literature. The effects of institutions on poverty, however, have been less investigated. This is also true of the relationship of institutions with globalization and how this has influenced its impact on poverty—or, conversely, the transformation of institutions as well as the transformation of their effects on poverty.[10] It is argued here that the effects of institutions are not linear; they follow processes of cumulative causation, create threshold effects, discontinuities and self-sustained poverty traps.[11]

Causalities and threshold effects work through several retroactive channels, from globalization to poverty, and from poverty to ways of coping with globalization (for example, trade policies). This in turn induces specific impacts of globalization. The impact of globalization on poverty through institutions may be positive or negative.

Two causal processes may be distinguished. The first is the impact of globalization on institutions. Globalization is a factor in institutional change, which in turn may have positive or negative effects on poverty reduction. This causal process is, however, confronted with the asymmetry between the causal event (change in prices, mobility of factors) and its objects (institutions, norms). It is also confronted with the heterogeneity of the speed of transformation of the causal event (globalization) and its objects (institutions). The latter exhibits far more persistence than the former, which is why explaining growth rates by institutions remains puzzling (Easterly et al. 1993).[12] Institutions create stable expectations; the pace of institutional evolution thus tends to be slow, with more or less rapid transformation depending on the category and domain of the institution.

According to Fernand Braudel’s (1996) seminal distinction, three types of institutions correspond to three speeds of change: (i) social institutions and norms (incurring the

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[10] With exceptions, of course, on the necessity of appropriate institutions for harnessing the benefits of globalization; see Kozul-Wright and Rayment (2004).

[11] Non-linearities of the effects of globalization on the poor have been highlighted in many studies—while cumulative causation has been featured in theories of economic development since the 1950s—but without the focus on institutions, see Agenor (2002b).

[12] This indeed fuels the heated debate on institutions, geography, policies or structures (commodity dependence, terms of trade volatility) as fundamental determinants of growth.

slowest transformation),[13] (ii) economic structures, (iii) and political institutions (that are transformed the fastest) (Arrow 1998, Braudel 1996). Globalization as a set of flows and policies is more likely to induce transformation on the aspects of institutions that are already experiencing rapid change (for example, formal political or economic rules), and less likely on slow-changing institutions such as social norms.

The second causal process is the impact of institutions on globalization. Globalization is 'filtered' (intensified or hindered) by institutions at the country and micro levels (village, households). The mediation by institutions introduces unexpected consequences and non-linearities in the transmission mechanisms that orient them towards either beneficial or detrimental outcomes for the poor.

In summary, causalities follow three dichotomies: the positive effects of globalization versus its negative effects, respectively, (i) on the domestic institutions that are causes of poverty (exclusionary ones, like caste, for example); (ii) on institutions reducing poverty (household structure allowing accumulation, for example); (iii) on the institutions that enhance the positive aspects of globalization (such as economic freedom) or intensify its negative aspects (such as weak support for economic diversification).

1.5 Assessing causalities: issues of measurement and endogeneity

An increasing number of studies have put forward institutions as the key determinants of growth (Rodrik et al. 2002, Acemoglu et al. 2004; for an opposing view, see Glaeser et al. 2004).), which has given rise to heated controversies as to their exogenous character. Studies often rely on growth cross-country regressions, where institutions are used as determinants of growth in addition to more traditional variables (such as investment). Institutions are also used as explanatory variables in regressions explaining poverty or globalization. The variables that approximate institutions, however, are generally broad notions, such as trust, rule of law, protection of contracts and property rights, civil liberties, political stability, and social cohesion and homogeneity. There is now a consensus on the fact that 'institutions matter', but no consensus exists as to which institutions matter or on what the direction of the causalities is (Engerman and Sokoloff 2003b). Instruments are sometimes confused with explanations (Rodrik 2004), and models are often affected by implausibility and econometric flaws (Durlauf and Quah 1999).

Causalities are subjected to the endogeneity of the institutional variables vis-à-vis those they are supposed to explain (growth, level of income) (Basu et al. 1987), for example, between institutions, trade openness and poverty. Economic policies are particular outcomes of institutions, but policies, such as trade barriers, have been used as a proxy for weak institutions. Simultaneously, openness policies transform domestic institutions and their influence on poverty, and trade creates institutional forms.[14] Endogeneity also

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13 Speeds of change also vary within categories of institutions: monetary institutions may be changed more rapidly than labour institutions; in social institutions, codes of conduct may be changed more easily than kinship institutions.

14 See Greif (1989) on the contrast between the Maghribi and Genoese traders, creating different institutions and trust-building devices in the course of their trade activities.

affects the many studies that try to isolate the determinants of growth among the three categories of policies, geography and other endowment variables, and institutions.[15] Policies and institutions may be endogenous vis-à-vis each other, and even geography is not necessarily an exogenous variable (as shown by migration). Political institutions are also endogenous vis-à-vis growth,[16] as well as social and micro-political mechanisms such as trust and accountability.

1.6 The problems of observing thresholds and aggregation

The emergence of 'trust' or 'cohesion' and their causal relationship with particular forms of institutions and their effectiveness represent complex processes that depend on context and are best observed through case studies. Econometric exercises work at an aggregate level and observe aggregate threshold effects. They are ill-equipped, however, to apprehend the multiple micro-mechanisms and norms, as well as the underlying threshold effects that stem from the influence of institutions. Indeed these norms work at the individual or group level and contribute to the effectiveness of an institution (and its credibility), hinder or intensify the gains or losses from globalization, build local poverty traps or trigger opportunities for escaping them.

Institutional variables may be discrete, stable in space and time, and lend themselves to quantification and aggregation. Many institutional variables, however, do not exhibit such properties of stability in time and space (the former on account of historical transformation and the latter because of adaptive, borrowing processes). Isolating threshold effects in the impact of globalization, however, requires aggregate data, which are typically not used in qualitative analyses. The latter in turn only observe particular before–after processes, which are *sui generis* cases and cannot be aggregated, particularly in the case of micro institutions and institutional change. A methodological difficulty remains in this tension on the one hand between models that assess non-linearities but with questionable concepts of institutions and, on the other, case studies that may have appropriate concepts but do not use aggregate data.

2 Threshold effects due to the very nature of institutions: institutions as composite arrangements

2.1 The different components of institutions: forms and contents

Institutions are composite sets of rules that shape various levels of human cognition and activity. They are simultaneously constituted by forms—i.e., names, organizations—and contents—i.e., functions, meanings—which display distinct evolutions and speeds of change. Institutions that bear similar names do not possess identical credibility, capacities of regulation and generation of incentives from one environment to another. The actual form and content of institutions are determined by several factors—history, cumulative processes, level of economic development, and state capacity, among others.

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15 For defenders of geography, see Bloom and Sachs (1998), Easterly and Levine (2002).

16 Bardhan (1993), Przeworski and Limongi (1993). Aghion et al. (2002).

Their rules organize the behaviour of different agents (individuals, households, firms, governments), settings—market (agricultural production, labour markets, access to capital, human or financial, for example) and non-market activities (state institutions, for example)—and economic sectors (rural, industrial and financial, for example).

Therefore, the impact of globalization on the poor cannot intrinsically be a linear process. Institutions do not constitute discrete entities that enter into unambiguous relationships with other similar variables. The channels and mechanisms of the impact of globalization are altered by local institutions that are in fact constituted by distinct components. Under apparently similar forms, the effective contents of given institutions may differ: these apparently similar institutions therefore channel the impact of globalization on the poor in different ways—for example, depending on contexts, positive, negative, first positive then negative, or both positive and negative according to the domains considered (economic, financial, social, or political).

2.2 Efficiency of institutions as an outcome of relationships between components

The 'formal' existence of institutions provides individuals with little information as to their effectiveness, and few stable expectations on the way individual behaviour is ruled by these institutions, and hence on their effective functions ex post. The 'formal' existence of institutions provides little information on the effective enforcement of rights or rules (property rights, rule of law), or on the 'capture' of institutions and legal systems by interest groups. Functions of institutions do not map into unique forms, as argued by Rodrik in the case of weak property rights in China: their various functions (such as providing stability for investment) are achieved by other institutions, in contrast with Russia, where institutions formally exist but do not fulfil their functions (Rodrik 2004). The formal existence of institutions does not imply the similarity of their local content across time and across countries or settings (for example, the content attached to 'accountability', investment regulation, or safety nets). The mechanisms leading from globalization to poverty via institutions are therefore under-determined ex ante. Threshold effects, positive or negative, stem from the effective content and functions of institutions that underlie their formal existence, and may be more accurately analysed case-by-case.

Indeed the efficiency of institutions stems not only from their constitutive elements (forms and contents) but also from the relationships between these components, and from their relationships with other institutions (Sindzingre 2003). Institutions, as composite sets of rules, are more or less pervasive and effective; their effects are observable ex post for they result from a combination of institutions in addition to exogenous variables (such as endowments, land abundance, climate). For example, redistributive institutions, such as those supporting land reform, have different effects on poverty depending on whether they combine with land abundance or scarcity.

Therefore, the effectiveness of institutions aimed at helping the poor to cope with trade liberalization is not only made up of various constituents (policy measures, organisational rules) but by the relationship between them. Effectiveness depends, for example, on human capital, political economy, social 'trust' or 'cohesion', as well as on the relationship with other institutions (such as those supporting technology, information, rule of law). For example, the effectiveness of business regulation is contingent on the presence of effective judicial institutions. The impact of policy measures, such as trade, industrial, or diversification incentives focused on the poor, is contingent on institutional combinations, particularly state capacity.

Forms do not correspond to unique contents, and growth results from contingent combinations of policies, structures and institutions. For example, institutions dealing with safety nets have often been inefficient in SSA, while limited state-provided safety nets did not prevent Asian countries from exhibiting a positive link between globalization and poverty. Authoritarianism has been combined with poverty reduction in South Korea (a 'developmental state') but not in the predatory political regimes often found in SSA. In Taiwan authoritarianism has also been combined with an output based on small and medium enterprises (absent in SSA), based on specific models of growth, poverty reduction and a combination of economic structure, initial conditions, geography, political regime, policy, and external integration.

Mental models, as argued by North (on shared mental models see Denzau and North 1994), and individual perceptions (of poverty, inequality, and security) also shape the relationship between the various institutional components. Thus 'failed states' are characterized by self-reinforcing traps caused by social fragmentation that are further compounded by domestic poverty, the internationalization of resources,[17] and the negative perceptions of all players, local and external (investors, donors). New institutional economics recognize the credibility of institutions and commitment by governments as being essential determinants of growth. Promises that are not credible in uncertain situations are characterized by low investment and preference of the status quo (Fernandez and Rodrik 1991). New institutional economics defines credibility as a commitment to secure private rights; [18] this view however is unclear as to what combination of elements render an institutional form effectively credible ('believed') and binding, given that political power possesses, by definition, the authority to denounce this binding. In addition, securing private rights may be not the main element to achieve credibility or growth, especially in low-income countries. State institutions and government commitment to policy reforms are often perceived as having been 'privatized' by political clientele and special interest groups, and thereby project low credibility.

2.3 Discontinuities between micro and macro levels

Institutions induce discontinuity in the channels that lead from globalization to poverty and poverty reduction; this discontinuity being determined but not easily predicted ex ante. The influence of institutions depends on functions, contents, and effectiveness that are observed ex post, especially regarding credibility, social cohesion, and the coherence of policies with institutions. Moreover, institutions induce discontinuities between micro and macro levels: causal mechanisms at the household level are not necessarily homologous to those operating at the macro (regional or country) level, for example, those linking growth and education, or income and education or health (Kanbur 2001). Discontinuities also arise from individual perceptions that may weigh

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[17] See Reno (1998) on the globalization of warlordism in SSA.

[18] On the credibility of political institutions in seventeenth century England as a key factor of growth, see North and Weingast (1989).

different dimensions of poverty and inequality.[19] Aggregate threshold phenomena hide multiple microeconomic mechanisms that could explain possible unexpected effects. For example, micro group structures and hierarchies regulating access to capital and credit may transform the results of trade liberalization into an oligopoly controlled by a limited number of traders.

Micro norms may unintentionally shape macro institutions: unwritten, customary (‘informal’) norms may modify the formal missions of public institutions, may work against them (through corruption) or may provide their legitimacy. Policy credibility is also a mechanism that introduces discontinuities between the macro and the micro levels, as well as problems of time consistency and anticipations of policy reversals. Even well devised reform (such as liberalization) may fail if civil servants adhere to different customary norms that are better-enforced (and may build self-enforcing equilibria). For a similar set of reasons, many of the poor targeted by otherwise well-designed safety nets may be never reached.

3 Threshold effects created by the political economy of institutions

3.1 The political economy dimension of institutions

Institutions may be conceived as being primarily shaped by political economy, reflecting the interests of groups in power at the expense of efficiency and the welfare of society, with no outside agency providing credibility to their commitments (Acemoglu 2002, 2003). Political economy, however, can also channel the positive effects of institutions towards growth, through political participation, social cohesion and management of social conflict, particularly when the latter is caused by external shocks and globalization (Rodrik 1998a, 2000, Thorbecke and Charumilind 2002).

The impact of globalization is influenced by domestic political economy structures and institutions such as social polarization, oligarchic structures, and predatory regimes, which may bias, distort or cancel the gains from globalization for particular groups of poor. One of the channels of the negative effects of inequality on growth is explained by a country’s political economy (e.g. pressures for redistributive fiscal policies: Benabou 1996, Alesina and Rodrik 1994, Bourguignon 2004b). The influence from political economy, whether positive or negative, is contingent on the nature of the groups devising the rules, their behaviour (productive, rent-seeking, exploiting institutions as resources), time horizons, and the intergenerational motives that shape their interests in redistribution and social cohesion.

As shown by the example of Latin America, institutions born of a legacy of high economic and political inequality (land rights, schooling, financial institutions), and that prevent large segments of society benefiting from economic opportunities, go so way to explaining poor growth performance.[20] In combination with tropical commodity

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[19] See Ravallion (2004) on perceptions of inequality that differ depending on whether weights are given to people or countries.

[20] Engerman and Sokoloff (2003a), Robinson (2000) on the determinants of inequality in Latin America as primarily political.

endowments this had led to the emergence of parasitic elites and a low level of public goods (universal education, for example), which have contributed to slowed growth (Engerman and Sokoloff 2000).[21] Indeed low income and commodity-exporting countries exhibit high levels of inequality and polarization.

Political economy mechanisms contribute to threshold effects not only at the level of institutions but at the level of government policies, as both levels are endogenous to each other. For example, domestic political economy impinges on trade policies and therefore transforms the impact of globalization on to the poor. Thresholds effects depend on particular contexts (for example, income levels, inequality, factor endowments, possible poverty traps created by resource abundance,[22] budget constraints and government's redistributive preferences, the balance between interest groups, or the skewedness of political representation) and follow various channels, such as higher public spending (Rodrik 1998b, Garrett 1999, Boix 2002)[23]. In low-income countries characterized by inequality, rich elites appear to benefit more than the poor from trade openness, while in higher-income countries, the middle classes and the poor draw greater benefits from openness (Milanovic 2003a). The gains from global integration, in conjunction with democratic pressure, may also improve the situation of the poor by expanding access to education and lowering inequality, but the gains may be eroded by demands for government consumption and redistribution (Tavares and Wacziarg 2001).

3.2 Public institutions against the poor

Rational choice approaches have highlighted the role of incentives and interests, with public institutions serving as political markets for organized groups competing for power. Particular groups may 'capture' existing institutions. They may also refuse access to institutions and associated rights (such as land rights) to certain groups and individuals, even although the latter may be entitled to benefit from these rights and enjoy access. Institutions intrinsically include political contents and power relationships as rules, by definition, constitute both inclusive and exclusionary devices, and inherently create beneficiaries and losers.[24] The particular design of institutions and actual enforcement of contracts and rights may *in fine* be analyzed as the outcomes of political power relationships.

'Empowerment' has been put forward as a key mechanism of poverty reduction.[25] It requires necessary conditions such as the existence of legal rules, which are, however, not sufficient. The institutions' (empowerment) impact on poverty is influenced by the

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21 On oligarchic political economy see Bourguignon and Verdier (2000).

22 Against the thesis of the 'curse' defended by Sachs and Warner (e.g., 2001), see Blomström and Kokko (2001) on Sweden and Finland; on the positive relationship between resources and growth when associated with appropriate political institutions, Sala-I-Martin and Subramanian (2003), Acemoglu et al. (2001).

23 See Barro (1997) on the non-linear relationship between political institutions (democracy) and growth.

24 Wars and conflicts have been viewed as the historical root cause for the emergence of states in the Western world, see Tilly (1985).

25 For example, by the World Bank, along the lines of Amartya Sen's conception of poverty.

type of political power that backs the enforcement of the rules, rights and contracts. Individuals may have rights, but if the apparatus of political power or competing traditional institutions prevent them from being enforced, formal institutions may be worthless. The effective content—function, meaning, credibility—of public institutions is not the pure translation of their formal dimension (such as courts and elected parliament). Institutional forms may be similar, but contents may be growth-enhancing, poverty-reducing, or emerge as predatory institutions. It may even be in the interest of a predatory ruler to prevent the consolidation of developmental institutions, which may threaten his/her power and monopoly on rents (Robinson 1996).

Clienteles and corruption also crucially affect the redistribution of gains and losses created by globalization in general and to the poor in particular. They prevent the poor acceding to credit, investing, diversifying their economic activities and benefiting from basic public services like health and education that are necessary to harness the opportunities offered by globalization. For example, state service provision is recognized as essential for improving social indicators. Depending on its effective contents (organization, degree of corruption), however, it may either reduce poverty or function as an extorting device. Credibility and accountability of public institutions and policies are the 'contents' that can account for the discontinuity in the beneficial effects of institutions on poverty. In some low-income countries, because of political economy characteristics and weak institutionalization, the poor indeed perceive state institutions as being one of the causes of their poverty. Under certain thresholds, legal, health or educational infrastructures may act against the poor; above these thresholds these institutions may help the poor.

Therefore, in a polarized context where rules are devised by and for groups in power, the functioning of state institutions may work against the poor, exclude them from the gains of global integration, and create inequalities. As institutions intrinsically include a political dimension, the types of winners and losers, domains and effective contents of rules and rights, and the groups with access to these rules and rights, result from events that are contingent and unpredictable ex ante. Winners and losers depend on the balance of power (i.e. which groups exercise power while others see their rights denied), and whether the objective of the group having the capacity to devise or manipulate the rules is redistribution or equality.

4 Threshold effects and poverty traps induced by social institutions

The diversity of the initial effects of globalization via institutions is examined at the level of social institutions and norms (household, group institutions, or 'micro institutions').

4.1 Effects of globalization on micro institutions and poverty: a slow transformation

The impact of globalization on poverty is mediated by local institutions, which create threshold effects both in modifying this impact and in transforming themselves under this impact. Aggregate observations—such as the fact that globalization and growth have been pro-poor in some regions and not in others—in fact correspond to a multiplicity of micro mechanisms. In rural areas links to markets, education and access to land are key endowments (Christiaensen et al. 2003), which are regulated by social institutions, for example allocating rights to education or land according to gender, age or status.

Local and social norms at the micro level change slowly and the impact of globalization is more likely to be channelled by local institutions than by transforming them in a spectacular way. Certain social norms show significant resilience, such as division of groups according to particular criteria (occupation, class, race, and so on) or political allegiance.[26] Self-enforcing mechanisms and status quo bias may explain the resilience of social rules though their intrinsic inequality and, in some cases, inefficiency (Bowles 2004).

Institutional changes tend to work at the margin, 'inside' institutional forms. Traditional institutions may erode under the pressure of market integration, with the content and functions evolving under similar institutional forms (forms may evolve later). For example, customary land tenure may lose its social security and equity functions through individualized land rights and land concentration arising from market transactions (especially when combined with demographic pressure) (Platteau 2002). Similarly, a market 'content' may progressively characterize non-market institutions such as kin groups (using family for unpaid labour, for example). The trust mechanisms that accompany traditional networks may likewise be used in order to facilitate collective action towards entrepreneurial objectives.[27]

4.2 Globalization transforming micro institutions, or channelled by them

Global integration—the transmission of world prices (including volatility to farmers in the export sector)—impacts local prices, return-to-assets and incentives. The move towards lesser state intervention (stabilization schemes, for example) also alters customary rural institutions such as insurance mechanisms and tenancy contracts.[28] Land-abundant and labour-scarce low-income countries historically enjoy elaborate property rights 'in man' (kinship systems, rights on labour) and not only 'in land'. Global integration and economic transformation have historically constituted key factors of change in these sets of rights.[29]

On the other hand, local social institutions channel and modify the impact of globalization in negative and positive ways, depending on their history, and their particular structure and combination with other economic variables; as in the case of land tenure arrangements, inequality in land rights (ownership or access), and modes of

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[26] On the persistence of racial markers because of distorted cognitive processes, see Loury (2004).

[27] On the 'network advantage' of traders in SSA, see Fafchamps (2002).

[28] As in the Ivory Coast where increasing competition and direct exposure to international markets have called into question the customary rights allocated to Burkina Faso tenants, sometimes leading to their expulsion.

[29] In particular the disappearance of rights 'in man' (slavery, forced labour), see Engerman (1973), and Feeny (1989) on the replacement of rights 'in man' by rights 'in land' in Thailand in the nineteenth century.

revenue collection. History and path dependency indeed contribute to non-linear effects, for the impact of institutions on economic performance persist over time. As shown by Banerjee and Iyer (2002) with land rights and tenure in India, different historical (colonial) property rights have led to varying economic outcomes; for example areas where rights were granted to landlords exhibited lower agricultural investment, productivity, and investment in public goods than in areas where rights were given to the farming peasants. Land tenure and distribution are a key source of agricultural productivity and scale effects (increasing or decreasing returns).[30]

4.3 The ex ante indeterminacy of the effects of social institutions

Micro institutions and norms have ambiguous effects. There is ex ante indeterminacy in their response to globalization as well as in the effects of their response on poverty, which depends on their actual contents and how the opportunities created by globalization alter the previous institutional interactions and equilibria and induce new incentives. Institutions change depending on the context, to become adaptive or dysfunctional. They may create self-reinforcing traps, lock-in economic change in path dependency, or induce increasing returns as in the case of the adoption of a particular institution or technology. Micro institutions are fragmented; a specific element (a form or content) of an institution may have positive effects but which may be cancelled by other elements. Coupled with weak states and a predatory political economy (in customs services, for example), market integration and lower trade barriers may intensify 'informal' norms and routines. Changes in technology or the value of a resource may be harmful as well as beneficial.[31]

In rural areas, social inequality is likewise an important source of inefficiency, as it may be an obstacle to collective action (Baland and Platteau 1999). Local institutions, however, induce inequality according to discriminatory criteria based for example, on age, gender, and group membership within separate domains (production, consumption, technology, education, or communal politics). Inequality in a particular domain (land rights, production, labour, kinship) can therefore be attenuated by different hierarchies or by egalitarian arrangements in other domains.

Similarly, as is well-known, SSA households rarely follow the unitary model. Women and men exercise different agricultural activities that reflect separate use and ownership of income[32]. Changes in relative prices and new market opportunities induced by globalization may modify and even reverse previous income inequalities.

In developing countries, property rights coexist with other rights and uses, such as the variety of flexible arrangements that govern the exploitation of natural resources—although institutional economics often equate institutions with property rights and view stability as a factor of efficiency, promoting growth and poverty reduction. Flexibility and instability have even been viewed as key features of 'communal rights' as opposed

30 Mwabu and Thorbecke (2004); Banerjee (2000) on the returns of land reforms.

31 Alchian and Demsetz (1973) note the increased value of fur for the American Indians that led them to devise private rights in land that were consistent with a market economy.

32 On separate accounts in the case of Ivory Coast, see Duflo and Udry (2003).

to private rights. Secondary rights or derived rights (access to land and land use) constitute flexible arrangements that are adaptations of local institutions (for migrant farmers, for example) (Lavigne-Delville et al. 2001, Lambert and Sindzingre 1995). These flexible arrangements may be efficient: the formalization of customary rights into property rights, which accompanies market integration, does not necessarily lead to greater efficiency in reducing poverty and creating markets, as in SSA—where private property rights have sometimes eroded customary cooperation rules, increased the perception of inequality and intensified redistributive conflicts.

Social institutions however, may be inefficient in a context of norms that are shared by groups of limited size, as in the case of customary arrangements in rural areas (for example, risk-sharing and insurance)[33]. Formalized state institutions and legal systems, though possibly inefficient (corrupt, maybe), can provide the poor with protection against local institutions, which may be highly inequitable—and the collapse of these inefficient legal systems may be harmful for the poor, as has been the case in various transition countries.

4.4 Poverty traps created by social norms

The negative or positive outcome of social norms are illustrated by the well-known issue of the fragmentation effects of group affiliations (Easterly and Levine 1997), and their controversial impact on growth and poverty reduction. As noted by Bowles (2004), the poor find themselves at a disadvantage in implementing large-scale coordinated collective action that aims at more equal institutions; moreover, they lack information more than others do. Norms allow cooperation, risk-sharing, provide insurance and local public goods via various enforcement mechanisms (trust, reputation, reciprocity). They may alleviate—but cannot suppress—the other poverty trap mechanisms. ‘Social assets’ may alleviate elements of persistent poverty such as low returns on uneducated labour and financial constraints (Adato et al. 2003). However, the scope for exchanges, the capacity to enforce rules and punishment, and the control of free-riding tend to be confined to the members of networks. (Greif 1989, 1994, Platteau 1994, Fafchamps 1992).

Groups reinforce solidarity and protection, but they also exclude. Lack of social affiliation implies greater degrees of freedom, but also limited access to capital or credit. Shared norms (based on occupation, ethnicity, location) sustain networks that encourage capital accumulation and are better able to take advantage of globalization (such as international trade networks; Malaizé and Sindzingre 1998). They alleviate poverty by reducing the cost of access to capital, credit and labour and via mechanisms supporting mutual assistance.

Shared norms simultaneously induce discontinuities and threshold effects in the potential benefits of global exchanges[34]. They foster social fragmentation (discrimination, prejudice) and build separated social identities that receive different payoffs for their actions, orient choices and economic behaviour (Akerlof and Kranton

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[33] On the inefficiencies of traditional social arrangements, Platteau (1997, 2000).

[34] On the detrimental effects of social heterogeneity and fractionalization, see Alesina and La Ferrara (2001) and Alesina et al. (2002).

2000), lower participation in social activities, hinder collective action, and bias the redistribution of public resources towards certain groups and against others. The multiplication of nation-states in history reveals the relevance of state institutions in creating and attenuating redistributive conflicts. Ethnic membership is also an expression of unequal access to and competition over public goods, infrastructure, political and natural resources, and of the incapacity of state institutions to provide credible solutions (Sindzingre 2002).

Globalization's positive effects may be locked-in by group-building institutions, which politically or economically exclude groups from its benefits (for example, politicians using public revenues from external trade for redistribution towards their ethnic group). Parallel with other factors, though, globalization may exacerbate competition and social fragmentation, while eroding the previous mechanisms of control of opportunistic behaviour (extreme cases being the conflicts fuelled by the international exploitation of natural resources).

Finally, self-reinforcing poverty traps may be built by social institutions, on which globalization may have an aggravating impact. Social discrimination against occupational or ethnic minorities, for example, gives rise to poverty traps in creating differences in returns to productive characteristics.[35] Likewise, when exposed to a market economy, kinship arrangements and their rules of reciprocal exchange and obligation may distort labour markets. Institutional forms (kinship, modern organization of the firm) seem to be stable but their contents are skewed towards new functions and effects (recruiting on the basis of kin and not competence, excluding non-members). Globalization may even reinforce kinship institutions, as opportunities of improvements in the context of uncertainty may lead to a preference for the status quo ('collective conservatism'[36]) and hence build poverty traps. Poverty traps are induced by conservative risk-coping and investment strategies, as the poor are close to subsistence and invest in assets with low returns while the wealthier invest in higher-risk and higher returns.[37]

4.5 Virtuous processes induced by globalization

In contrast, globalization may induce positive institutional changes in local institutions. Reliance on social transformation, mediated by public policies such as legal reforms regarding social status or land (right, contracts), may have positive effects in terms of poverty reduction, efficiency and productivity.[38]

Conversely, the pre-existence of certain micro-institutions when economic activities are exposed to globalization may trigger virtuous paths that reduce poverty. Higher levels of 'participation' lead to better economic outcomes and better public goods provision (Banerjee and Iyer 2002). Following the dismantling of state marketing boards, producers who constituted membership-based organizations and associations were more

35 Van de Walle and Gunewardena (2001) on the example of ethnic minorities in Vietnam.

36 Hoff and Sen (2004), relying on Fernandez and Rodrik (1991).

37 Among a vast literature, see Zimmerman and Carter (2003).

38 Banerjee et al. (2002) on the reforms of tenancy laws in West Bengal in the late 1970s.

able to overcome collective action problems and the fragmentation of customary institutions, and act as intermediate institutions vis-à-vis international markets.

Within the same rural areas, households that have organized themselves (choosing crops, for example) in order to diversify their source of income have better exploited globalization, and vice-versa: households that were least diversified incurred more negative effects. In Mali for example, some households simultaneously engage in cash crop (cotton) and food crop agriculture, in tandem with tenancy arrangements on cocoa plantations in neighbouring Ivory Coast (the world's main exporter), thus adding the remittances to their income through the use and adaptation of traditional household structures (such as large households) (Hillborst et al. 1999).

5 Poverty traps compounded by macro conditions

Threshold effects may emerge at an aggregate level, which translate threshold effects occurring at a micro level—the micro-macro distinction is used only for heuristic reasons as there is a continuum between these levels and a combination of institutional forms and contents. This is shown by the examples of poverty traps created by trade structure and the institutions coping with external shocks. Poverty traps may be generated through reciprocal interactions between the macro and the micro levels, involving public institutions and policies, and individual responses mediated by social institutions. The continuum between micro institutions (organizing status and rights according to age, gender, occupation) and macro institutions (the public or 'modern' sectors) may build traps that separate the poor from individuals who can trigger a process of wealth accumulation (Azariadis 2004).

5.1 The cumulative processes created by the interaction between public policies and institutions

In low-income countries, particularly commodity-exporting ones, the cause of poverty is less globalization than the structure of economies and exports. An increase in trade does not reduce poverty in low-income countries (the 'international poverty trap' that stems from commodity export dependence) (UNCTAD 2004). State institutions and policies, however, contribute to a cumulative process and threshold effects, in creating devices that either maintain, aggravate or reduce dependence, and modify the existing economic structures. Price stabilization schemes, monopsonies, and marketing boards have been implemented by states as interfaces between global markets and producers. In some countries these institutions, combined with political economy and economic elements, have been inefficient, inequitable or even predatory (for example, when taxing producers in order to finance political interest groups) (Deaton 1999).

International commodity price volatility however, includes thresholds below which peasants limit risk, investment, loans and diversification in more productive crops and non-farm activities (and above which they do).[39] Depending on particular institutional

[39] Among a vast literature on shocks (price fluctuations, weather), vulnerability, and rural risk management, see Fafchamps (1999, 2000) and Dercon (2002).

and economic combinations, interlinked contracts implemented by state stabilization and marketing schemes have smoothed the pass-through of world price changes and protected commodity producers from volatility. They have been efficient risk management tools in the context of inefficient market mechanisms, financing agricultural inputs, providing credit, stabilizing income expectations, and providing insurance, as for cocoa in Ivory Coast or cotton in West Africa.[40]

Domestic trade liberalization policies starting in the 1980s have exposed commodity producers to the large and asymmetrical effects of world price volatility.[41] After the dismantling of stabilization schemes, non-state institutions did not fully substitute for their functions, domestic and external. Market mechanisms alone may be unable to provide the security previously provided by state schemes. Local market mechanisms controlling opportunistic behaviour among intermediate private buyers may be inefficient, with producers having to cope with the unpredictability of prices and profits, limited access to credit, capital and inputs. In SSA, the historical weakness of the domestic private sector sometimes made it so that the opportunities offered by liberalization were captured by intermediaries.[42] Market power here shifts from producers to a small number of concentrated private actors. The liberalization of the coffee market, for example, did not improve price transmission, and private actors became concentrated at the processing and retailing levels (Sheperd 2004). In the Ivory Coast, subsequent to the liberalization of the palm oil sector, production and quality were reduced due to the cost of inputs, segmentation of production, and the disappearance of the public institutional framework that provided security, learning, coordination and sanction of opportunism (Cheyns et al. 2001).

Rural institutions, however, may also be inefficient because of covariate risk (climatic, for example). Rural associations may be affected by problems of inadequate information, transaction costs incurred from limited scale, problems of coordination and collective action, weak market bargaining power vis-à-vis a few international trading firms, and efficiency-equity dilemmas that are detrimental to the poorest producers.[43] Producers have responded to exposure to international price fluctuations with permanent income strategies leading to over-production, as for cocoa in Ivory Coast, in turn increasing price volatility. The known threshold effects stemming from the fallacy of composition typically constitute a trap that results from information and collective action problems. There have been winners, but inequalities may have also been created: when benefiting from better access to markets (such as roads), for example, commodity producers may have benefited more from liberalization than those producing food crops (Bourguignon and Morrisson 1992).

The ways public and social institutions, as well as the interactions between them and with market structures (for example, increasing returns), are modified by liberalization channel the impact on the rural poor. Discontinuous and non-linear characteristics of

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40 On the effects of liberalization of cotton, see Poulton et al. (2002).

41 Cashin et al. (2002); on the asymmetric effects of downturn on poverty, see Agenor (2002a).

42 On the oligopolies in the cotton sector in Zimbabwe, see Larsen (2002).

43 On the cocoa and cotton sectors in West Africa after liberalization, see Araujo-Bonjean and Combes (2001).

this impact were pointed out by Rosenstein-Rodan (1943): rural markets at early stages of development suffer coordination failure, multiple equilibria and underdevelopment traps with lack of growth under certain thresholds. Combining the macro and micro levels, underdevelopment traps create threshold effects. As shown by Hoff (2000) in the example of China, micro features (modernization, diversification) may determine local poverty traps among farm households. Various spill-over effects (externalities) may lead to a series of traps (in terms of investment, technology) with low innovation and inefficient institutions.

5.2 Public institutions and policies as instruments of transformation

Globalization may trigger institutional change. State institutions and policies, however, reorient the effects of globalization on institutions and poverty as well as the effects of local institutions on poverty—for example, industrial, trade, social policies. Government policies, and not only institutions, contribute to the formation of poverty traps and are endogenous to these institutions ('state failure', 'political failure'; see Besley and Coate 1998, quoted in Hoff 2000). Depending on the environment (for example the political economy), policies may be affected by credibility problems and be unable to reduce poverty or attenuate shocks (Ravallion 2001).

Public policies, laws, and institutions also have the capacity to sustain a change in social norms and micro political economy mechanisms in a way that benefits the poor, when combined with political institutions, for example democracy—though democracy is endogenous to the political economy (the effective content of democratic forms may be clientelism). A wider distribution of benefits not confined to the rich or to individuals who are affiliated with a particular group falls within the domain of public policy and the legal apparatus (one example being affirmative action). Effective local democracy and accountability in rural areas have positive effects on poverty (Foster and Rosenzweig 2001), and democratic countries seem to be less ensnared in the 'fractionalization-as-politics' trap (Milanovic 2003b, on the case of SSA).

Public policies have positive impacts on institutions, on their effect on the poor, and on the effects of globalization, when they correct market failures—for example through facilitating access to finance (on India see Burgess and Pande 2003, Besley 2003), supporting rural industrialization (Foster and Rosenzweig 2003), and basic public services, such as female education (Ravallion and Datt 2002). Public policies may support market-related institutions as they did historically for merchants during the transition to capitalism (Milgrom, North and Weingast 1990). They may likewise ease the global demand for goods produced by the poor (Basu 2003). Particular combinations of institutions, policies, and economic structures however, are what determine *in fine* the impact of globalization. Elements taken separately have unpredictable effects but the outcomes of their combination may be growth and poverty reduction.

6 Conclusion

This paper has focused on the relationships between globalization, poverty and institutions. While the relationship between institutions and growth is now a matter of increasing attention, this has been less the case regarding the whole causal chain linking globalization, institutions, and poverty. Assessments of the impact of globalization on the poor have revealed marked divergence in the literature. It has been shown that the threshold effects created by institutions constitute a dimension of the explanation of these diverging impacts. The triangular causalities that relate globalization, poverty and institutions constitute multiple, endogenous, cumulative and non-linear processes.

Institutions mediate the impact of globalization on the poor. Institutions have been analyzed following an original theoretical approach that views institutions as composite arrangements. It disaggregates the concept of institution according to its various components (forms and contents) and their particular combination.

Because institutions are composite arrangements, they create discontinuities and generate threshold effects upon the positive or negative effects of globalization, with social institutions and norms being a case in point. Institutions may also generate poverty traps. These threshold effects may be compounded by public institutions and policies. Conversely, globalization may induce a positive transformation of institutions. Institutions likewise enhance the impact of globalization and trigger virtuous paths that reduce poverty.

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